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CABINET

THE ATTACK ON INFLATION THE SECOND YEAR

Note by the Chancellor of the Exchequer

I attach for the approval of the Cabinet the draft White Paper on Counter Inflation Policy which I should like to publish next week.

D W H

Treasury Chambers

21 June 1976

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The Attack on Inflation the Second Year

*Presented to Parliament by the Secretary of State for the Treasury by
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THE ATTACK ON INFLATION THE SECOND YEAR

1. Britain needs a strong economy and a fair society. Achieving this is a task for the whole of our people, not just for the Government. It will require a sustained effort. But in the first year of the attack on inflation we have made a good start.

2. The damage done by rapid inflation is both human and economic. It cuts into the living standards of those least able to protect themselves. The housewife, the pensioner and the saver suffer first. The struggles of more powerful individuals or groups to escape its ill-effects only put more burden onto others. The inflation weakens mutual trust in our society and confidence in our institutions. Economic confidence too is threatened. Jobs are destroyed because industries cease to be profitable and their investment stops. People lose confidence in our economy. These are the dangers which faced us last year. Since July we have begun to pull away from them.

3. Our first objective now must be to see that the British economy pays its way in the world. This means getting rid of the balance of payments deficit; making British products competitive in world markets, and seeing that the resources our industry needs for exports and investment are there when they are needed. The world economic recovery gives us the best opportunity we have had as a trading nation for many years. Now we have to seize it.

4. Our second objective must be to rebuild British industry, especially our manufacturing industry. We have to make it more efficient, more productive, better able to innovate and to respond to new opportunities. That means putting more into new productive investment. In order to create the conditions for future improvements in living standards and public services, that investment has to take priority over any increase in other public or private spending for the next few years.

5. The third objective is to reduce unemployment and to maintain our social priorities. We can do this only by succeeding in the first two objectives and re-establishing our economy and our industry in the world. But as we make progress in putting the economy right, we must take every step we can to reduce the damage and waste that results from a high level of unemployment and, within the limits of our resources, we must protect the members of our society most in need.

6. The attack on inflation is fundamental to every part of this national enterprise. If we fail to control inflation we put every one of these objectives at risk. Thanks to the efforts of both sides of industry and of the whole British people, the first year of the attack on inflation is succeeding. The next section of this White Paper describes the progress we have made so far. This progress has been possible because the British people, including the millions of members of the trade union movement, have recognised the basic facts confronting the nation. The understanding which the British people have shown of the dangers we all face is the Government's greatest strength in tackling our difficulties. The Government will continue to take

the trade unions, industry and the public fully into their confidence. As part of the Social Contract the trade union movement has been more closely associated with economic management than ever before. Among the fruits of this have been the success of the first year of our attack on inflation, a dramatic improvement in industrial relations and the beginning of a new spirit of cooperation in British industry.

PROGRESS SINCE JULY 1975

7. Our inflation rate has been more than halved since last July. This is the measure of the achievement of the British people since the White Paper, "The Attack on Inflation" was published. And it has set Britain on the road to recovery.

8. In the first half of 1975 inflation was running at an annual rate of about 35 per cent. In the last 9 months the position has been transformed. The inflation rate in the first 6 months of 1976 is likely to be well under half what it was in the same period last year. By May 1976 the year-on-year inflation rate had fallen below 15½ per cent. In his Budget Speech on 6 April the Chancellor of the Exchequer said that in order to end next year with an inflation rate at least in line with our foreign competitors we must aim at a further halving of our inflation rate by December 1977. Further progress in reducing inflation is the key to all our policies.

9. The achievements so far would not have been possible without the voluntary £6 pay policy put forward by the TUC last July and endorsed by the Government. Since 1 August 1975, this policy has been fully observed throughout the economy. It has greatly reduced not only the rate of price and cost increases, but also the inflationary expectations of a year ago. Although there is still a long way to go, it has put the country in a very strong position to benefit from the recovery of world trade, with exports as the main stimulus to renewed growth in output. All the signs are that exports are growing much faster than the 10 per cent annual rate which the Government expected at the time of the Budget.

10. The Government have used all the weapons available to them to reduce inflation. The growth of the money supply has been strictly controlled, and cash limits have been introduced across a wide range of public sector expenditure. These measures were foreshadowed in last year's White Paper. Together with continuing controls on prices and dividends, they have complemented and buttressed the £6 pay policy.

Tackling unemployment

11. The trend of unemployment in 1975 pointed to disaster. The £6 policy played a large part in checking it. For their part, the Government have acted throughout the period since the 1975 Budget to alleviate unemployment by new measures on jobs and training. In that time they have made available over £400m in order to create or keep open 250,000 jobs or training places. Government measures have included a temporary employment subsidy, a recruitment subsidy for school-leavers, a job creation programme, an acceleration in the already fast-expanding programme for

adult retraining and placement, increased allowances for training and employment transfer and special allocations to industry to maintain apprentice-training during the recession. The main emphasis in the whole programme has been on helping young people and particularly school-leavers. In addition to these programmes, Government assistance to industry under the Industry Acts and other measures, or through the National Enterprise Board has helped to preserve or create jobs. These have included several hundred thousand jobs at risk in the motor vehicle industry, as well as about 70,000 jobs preserved or created through regional selective assistance. Several thousand other jobs have been preserved or created through help to firms in temporary difficulty and through accelerated project schemes.

Pensions

12. The Government have substantially raised the living standards of retirement pensioners, widows, and the long term sick and disabled. The National Insurance pension uprating in November last year brought the cash increase in the pension since the last uprating of the previous administration to some 70 per cent and the increase in real terms to 25 per cent. Over the same period the real value of the pay increases gained by the average man in employment were almost totally eroded by inflation. The Government have already announced further increases in National Insurance pensions to take effect in November 1976, which will bring the pension for a married couple up to £24.50 a week, and that for a single person to £15.30. The pension rates will then be practically double what they were when the Labour Government took up office. The increase this autumn will more than compensate pensioners for the rise in the cost of living over the preceding 12 months. It will also considerably exceed the likely movement in earnings between November 1975 and November 1976 and will take the pension to a new peak in real terms. The Government have fully met their commitment to raise pensions in line with earnings for the whole period since July 1974.

13. So the attack on inflation has made a great advance since last July and at the same time the Government have been able to maintain their major social priorities. But there are still great difficulties to be faced. Unemployment is still much too high. Wage costs per unit of output are still rising more quickly in this country than in our main competitor countries. And in the last few months there has been the unexpectedly sharp depreciation of sterling—a problem intensified by an upturn in world commodity prices, which has increased the foreign exchange costs of essential UK imports.

14. Inevitably, recent exchange rate movements have impeded our progress in the fight against inflation. Last July, the Government set a target of reducing the year-on-year increase in prices to single figures by the end of this year. It is bound now to take us somewhat longer to reach this target, but we should still achieve the objective of a further halving of the inflation rate by the end of 1977.

THE PROGRAMME FOR THE YEAR BEGINNING

1 AUGUST 1976: THE PAY POLICY

15. We are now entering a stage in our economic recovery in which world trade is increasing, and production the world over is growing to meet rising demand. This situation gives us the best opportunity the country has had since the war for export-led growth, with all that means in terms of higher UK output and employment. To get these benefits we have to maintain the momentum of the attack on inflation and consolidate the gains made in the last 12 months. Diverting resources into exports and investment requires both a high level of competitiveness in our industry and a basic change in the structure of our economy. This change is essential if we are to have a good prospect of rising living standards in future years; but we have to absorb its impact on our present living standards. If we try to improve our living standards by higher money earnings, we shall only get more inflation; it is just no good paying ourselves in confetti. The best prospect for seizing the opportunity of export-led growth, and achieving sustained improvement in our living standards, is to get our inflation rate at least down to that of our competitors, and to keep it there.

16. This was the objective to which this year's Budget proposals were addressed. For the first time, the Chancellor of the Exchequer offered to link substantial tax reliefs with a pay limit consistent with a further halving of the inflation rate. Following the Budget statement, Ministers embarked on intensive consultations about the next stage of counter-inflation policy: these culminated in the new agreement with the TUC on a pay limit for the next year equivalent to an increase of about 4½ per cent on average in wages and salaries. The Government endorsed the TUC proposal which limits increases to £2.50 for those earning up to £50 a week, to 5 per cent for those between £50 and £80, and to a maximum of £4 at all higher levels of earnings. Increases under the new pay limit, like those under its predecessor, will not be consolidated into basic rates. Because of the tight structure of this policy, the increase in average earnings to be expected over the next year is in line with that envisaged by the Chancellor when he proposed a pay limit in the area of 3 per cent coupled with tax reliefs. The Government therefore made clear on 5 May that, once the proposed new pay limit had been ratified by the TUC Special Congress on 16 June, they would implement in full the conditional tax reliefs outlined in the Budget.

17. People at work will benefit in three ways from the new pay policy and the tax reliefs associated with it:

- i. they will benefit from the pay increase itself, as described in paragraph 16;
- ii. they will benefit from the tax reliefs. By July or August, when all the reliefs will be operating, the average family will already have benefited by as much as £30. The amount of benefit will vary with family circumstances and levels of income. The tax reliefs operate from 1 April 1976, and will be in payment by not later than August 1976. For most people this means that the tax relief operates very

much earlier than the date for their pay increase under the new agreement;

- iii. they will benefit because prices will rise more slowly than they would with a higher limit. By the end of 1977 this reduction in inflation is expected to be worth as much to the average family as a pay rise for the breadwinner of £2 a week.

Annex A shows the benefits under i and ii above for different families and income levels.

Living standards

18. The dramatic increase in oil and other commodity prices in 1973/74 reduced our real national income by 5 per cent, at a time when we were already living beyond it by running an external deficit. The impact of that fall in national income was cushioned for a period by increased borrowing abroad, but much of the unavoidable decline in living standards of people at work came through in the first half of 1975. We now have to face the effects of the fall in the exchange rate and the need to direct more resources to exports and investment, with the benefits which that will bring for employment. The changes in the Price Code referred to later in this White Paper are part of this. But inflation will be lower, people at work will benefit from the tax reliefs linked with the new pay limit, and output and productivity will be recovering. Some further reduction in the real value of take-home pay (affecting single people more than families with children) is a necessary condition for reducing unemployment and getting the balance of payments right but the reduction in the real value of the average pay packet should be a good deal less than that experienced in the first half of 1975 before the £6 pay policy was introduced.

The pay limit for the next year

19. Annex B to this White Paper reproduces the TUC pay guidelines, endorsed by the Government for the coming year. These guidelines were adopted by an overwhelming majority at the TUC Special Congress. The CBI welcomed the TUC decision and said that their members would do all they could as employers to see that the guidelines were adhered to.

20. Increases within these new limits, as under the current £6 policy, are to be applied as a cash supplement to earnings, and in general the interpretation of the policy in particular circumstances will be the same as in the current period. Like the £6 these are the limits within which the amounts of increases are to be negotiated. There are no transitional provisions; for all groups increases within these new limits may be implemented 12 months after the major increase which they received in the previous period. For those to whom the £8,500 cut-off applied in the previous period increases may be implemented 12 months after the date on which an increase would otherwise have been allowable. An increment which has been withheld solely because of the £8,500 cut-off may be paid with effect from a date 12 months after the date on which it would otherwise have been allowable; alternatively an increment allowable on the later of these two dates may be paid, but not both. Separate increases in London weighting and other geographical allow-

ances will not be payable in the 12 months from 1 August 1976; but such allowances may be included as part of total earnings for the calculation of increases under the new pay limit.

21. The Government attach the highest importance to maintaining the principle of a voluntary policy. They therefore welcome this further agreement with the TUC on guidance to negotiators within the framework of the Social Contract; and they are confident that it will secure the same measure of acceptance and support as the £6 limit. These guidelines should be universally applied, and the TUC will oppose any settlement in excess of them. The Government will ensure strict compliance with the new policy throughout the public sector, as they have done with the £6 policy. The arrangements and sanctions in Cmnd 6151 to secure compliance in both public and private sectors will continue to apply.

22. The present voluntary arrangements through which the Government now collect information about pay settlements and intended settlements will continue. So will the requirement to supply pay information to the Price Commission for the purposes of price control.

PRICES

23. Even at the lower levels we are now experiencing inflation remains a heavy burden on all sections of the community and especially the housewife. But the consumer can look forward to a lower rate of inflation in the next 12 months than in the past year.

24. During the last year we made a major and successful effort to reduce the pressure of wage costs on prices, and the new pay limit will mean a substantial further reduction in that pressure. But there will also be new factors at work. With the recovery of the economy from the recession, we can expect rising productivity to moderate the rate of increase in unit labour costs. On the other hand we shall have to contend with substantial pressure from higher import prices, not only as a result of the depreciation of sterling, but also because of rising world demand for food and raw materials.

The Nationalised Industries

25. The operating deficits of the nationalised industries caused by price restraint have been eliminated. The exceptional price rises necessary for this purpose have now happened and future increases will in general be lower, broadly in line with the reduced level of price rises in the economy generally. The British Railways Board have announced that they will not be seeking any further fare increase during 1976, and the Post Office Corporation have said that they do not intend to increase the main letter post rates in 1976, nor telephone charges during the rest of the present financial year.

Food Subsidies

26. The Government have said that food subsidies will be progressively reduced as inflation is brought down and as social benefits are improved. But these subsidies still contribute substantially to the protection of people

on low incomes: over £400m will be spent on them in the year up to March 1977.

School Meals

27. There will be an additional subsidy of £35m so that the price of school meals will not have to go up in this financial year.

Price Controls

28. The Government propose to extend for a further year from 1 August 1976 the powers to control prices through the Price Code. There will continue to be both cost control and profit control under the Price Code and the Price Commission will continue to enforce it. The Government are determined to ensure that the results of pay restraint by people at work are reflected in the price level and that a strict control is retained. Some changes in the Code are however needed in the interests of investment and jobs, and they are described in a later paragraph. They are essential to our success in rebuilding industry and reducing unemployment.

PUBLIC EXPENDITURE AND MONETARY POLICY

29. Pay restraint and price control will not be effective in reducing the inflation rate unless other aspects of economic policy are also consistent with that objective. It is essential, therefore, that fiscal and monetary policy should contribute to the attack on inflation, and help the movement of resources into exports and investment. Failure to control public spending, or to ensure that the growth of the money supply does not stimulate inflation, would place the Government's programme in jeopardy. The Government have already declared their determination to ensure that the planned public spending totals, including those for local authorities, are not exceeded. In addition, for the current year, cash limits have been extensively applied to individual public expenditure programmes. Within the strict limits which have to apply to public spending, the Government's priorities will accord with the objectives set out at the beginning of this White Paper.

30. In addition to exercising firm control of public expenditure the Government are determined to see to it that the growth in the money supply does not stimulate inflation. The Chancellor has said he will ensure that the growth of the money supply is consistent with the Government's plans for the growth of demand expressed in current prices. The Government are equally determined that the expansion of productive capacity and exports should not be held back by competing public sector demands for finance. These policies will be reinforced if necessary by further action in the fiscal and monetary fields. Moreover, steps have been taken to ensure that the banks fully meet the needs of manufacturing industry for finance; any expansion of their business has had to be directed to meeting industry's needs for the expansion of exports, import saving, investment and working capital.

REBUILDING BRITISH INDUSTRY: JOBS AND INVESTMENT

31. The key element of the Government's longer term programme for the British economy is the effort to rebuild British industry. The essential conditions for success are control of inflation, which destroys markets and jobs and undermines the confidence needed for investment; and the provision of sufficient resources, real and financial, to get industry moving. On the one hand public demands on resources have for the present to be kept within tight limits. On the other industry has to be permitted, within the framework of the price control, to achieve sufficient profitability to generate the funds for investment and to offer the prospect of an adequate return on investment once undertaken. During the 1960s, the rate of return, after taking account of the need to replace fixed investment and stocks, was typically over 10 per cent. By 1974 it was down to 2.2 per cent. This has contributed to the recent slump in new productive investment and consequent loss of jobs. The downward trend in profitability must be reversed.

32. The Government therefore propose a number of changes in the Price Code to encourage investment and employment.

The main changes are as follows:—

- a. an increase from 20 per cent to 35 per cent in the rate in investment relief (that is, the proportion of the costs of new investment which may be reflected in current prices);
- b. provisions relating to the depreciation of assets and to the appreciation of stocks which (in line with the general conclusions of the Sandilands Report which the Government have accepted) recognise the damaging effects which inflation has produced;
- c. redefinition so as to take account of inflation of the categories into which firms fall, and which affect the procedures to which they are subject;
- d. measures to mitigate the present disincentive effect of the Code on improving efficiency, including the abolition of the productivity deduction;
- e. other measures to reduce the administrative burden on companies of operating the Code.

33. The Price Commission monitors investment relief to ensure that relief is only claimed where investment is actually taking place. To qualify, investment must be in home-based industry, and in plant, machinery, commercial vehicles and the construction of industrial buildings and warehouses.

34. The Government do not expect that the changes in the price controls will by themselves lead to any early or appreciable increase in the general price level. Market forces have ensured that the prices of many goods and services are now below the level which companies would be entitled to charge under the Price Code; but as economic recovery progresses, the Code will play an important part in keeping down the cost of living. By July 1977, when present powers to control prices expire, it is estimated

that the proposed changes in the Code will probably have made a difference of about 1 per cent to the Retail Price Index.

35. It is essential for our economic and industrial recovery that the resources released by these changes should be channelled into the productive investment in fixed and working capital which British industry needs to correct present weaknesses and secure a greater share of markets at home and abroad. This is also the objective of the Government's industrial strategy, now being developed in collaboration with both sides of industry. A good start has been made in the first stage of the industrial strategy. The National Economic Development Council is about to consider the first reports of the tripartite groups which have been working to produce proposals for action in many sectors of manufacturing industry. Planning Agreements and the National Enterprise Board will also have a key contribution to make to the regeneration of British industry.

LEGISLATIVE STEPS

36. The Government will ask Parliament to approve:

- i. a draft Order in Council extending until 31 July 1977 the operation of the Remuneration Charges and Grants Act 1975 and of Part II of the Counter Inflation Act 1973;
- ii. a draft Order to add this White Paper to Cmnd. 6151 for the purpose of the Remuneration Charges and Grants Act;
- iii. Ways and Means Resolutions and amendments to the Finance Bill to give effect to the conditional tax reliefs.

The two draft Orders are being laid before Parliament today and are subject to Affirmative Resolution by both Houses.

37. Details of the proposed changes in the Price Code are published today in a consultative document by the Secretary of State for Prices and Consumer Protection. After the consultations have been completed, the Secretary of State will make an Order to implement the amendments to the Price Code, to take effect from 1 August. The necessary Affirmative Resolutions will be placed before Parliament.

38. The present arrangements whereby dividends are strictly controlled will continue as before.

REALISM AND RECOVERY

39. The Government said last July that the programme set out in the "Attack on Inflation" was designed to save our country. Because that programme was adopted and implemented by all sections of the community acting together we have averted economic disaster, and can now tackle with fresh hope the fundamental problems yet to be solved. We need to switch resources away from consumption towards exports and productive investment; to get our inflation down to international levels and keep it there; to

conquer the social evil of high unemployment; to eliminate the current account deficit on the balance of payments; to adopt a new realism in our approach to public expenditure; and to accept that, for some time, living standards cannot increase in the way to which this country was accustomed in the years before 1973.

40. The £6 pay policy and the other policies set out in Cmnd. 6151 have given us a good start. We must build on these gains; we cannot risk throwing them away. The recent decision of the TUC Special Congress is a dramatic recognition of this. We shall have to maintain our policies of cooperation and restraint in pursuit of the objectives outlined at the beginning of this White Paper. If we do this, the opportunity is there for us to reassert our place in an expanding world economy as a leading industrial nation which can again offer its people a rising standard of living and of social provision.

PAY POLICY AND TAX RELIEFS: INCREASE IN NET INCOME

Married couple (wife not working)

Gross earnings	Increase in gross earnings			Tax Relief	Increase in net income	
	£pw	£pw	£pw		£pw	per cent.
30	...	2.50	1.48	0.88	2.36	9.7
40	...	2.50	1.48	0.88	2.36	7.8
50	...	2.50	1.48	0.88	2.36	6.5
60	...	3.00	1.78	0.88	2.66	6.3
70	...	3.50	2.07	0.88	2.95	6.2
80	...	4.00	2.37	0.88	3.25	6.0
90	...	4.00	2.37	0.88	3.25	5.4
100	...	4.00	2.60	0.88	3.48	5.3
125	...	4.00	2.20	2.09	4.29	5.3
150	...	4.00	1.95	2.74	4.69	5.0
200	...	4.00	1.60	3.91	5.51	4.8

* Before Budget increases in personal tax allowances and allowing for graduated national insurance contributions.

Based on personal tax allowances but excludes income-related benefits such as family income supplement and housing rebates.

Single Person

Gross earnings	Increase in gross earnings			Tax relief	Increase in net income	
	£pw	£pw	£pw		£pw	per cent.
30	...	2.50	1.48	0.40	1.88	8.4
40	...	2.50	1.48	0.40	1.88	6.7
50	...	2.50	1.48	0.40	1.88	5.5
60	...	3.00	1.78	0.40	2.18	5.5
70	...	3.50	2.07	0.40	2.47	5.4
80	...	4.00	2.37	0.40	2.77	5.1
90	...	4.00	2.37	0.40	2.77	4.8
100	...	4.00	2.40	0.63	3.03	4.7
125	...	4.00	2.17	1.52	3.69	4.7
150	...	4.00	1.80	2.34	4.14	4.6
200	...	4.00	1.60	3.09	4.69	4.2

* Before Budget increases in personal tax allowances and allowing for graduated national insurance contributions.

Based on personal tax allowances but excludes income-related benefits such as family income supplement and housing rebates.

Married Couple with two children under 11 (wife not working)

Gross earnings	Increase in gross earnings			Tax relief†	Increase in net income	
	£pw	£pw	£pw		£pw	per cent.
30	...	2.50	1.48	1.68	3.16	11.3
40	...	2.50	1.48	1.68	3.16	9.3
50	...	2.50	1.48	1.68	3.16	7.9
60	...	3.00	1.78	1.68	3.46	7.5
70	...	3.50	2.07	1.68	3.75	7.2
80	...	4.00	2.37	1.68	4.05	7.0
90	...	4.00	2.37	1.68	4.05	6.4
100	...	4.00	2.60	1.68	4.28	6.1
125	...	4.00	2.20	2.80	5.00	5.9
150	...	4.00	2.00	3.79	5.79	5.9
200	...	4.00	1.60	5.29	6.89	5.7

* Before Budget increases in personal tax allowances and allowing for graduated national insurance contributions.

† Including increases in child tax allowances.

Based on personal tax allowances but excludes income-related benefits such as family income supplement and housing rebates. Family allowance is assumed to be claimed at all income levels, claw-back has been deducted.

TUC PAY GUIDELINES

The TUC's pay guidelines agreed with the Government are set out below. These guidelines should be universally applied and the TUC will oppose any settlement in excess of them.

i. It has been agreed that the guidelines for increases becoming operative in the period August 1 1976 to July 31 1977 should comprise a percentage increase of five per cent on total earnings for all hours worked with a cash minimum of £2.50 and an upper cash maximum of £4 per week. The figures will apply to all full-time adults (aged 18 and above) with pro rata payments for part-timers and juveniles.

ii. This will be payable as an individual earnings supplement. It will entail employers each week calculating total earnings and adding five per cent to the result. If the answer is more than £4, £4 would be added. If less than £2.50 results, £2.50 is likewise added.

iii. The 12 months' interval between major pay increases should continue to apply. Where no increase has been received since August 1 1975 because of the cut-off requirements of the £6 policy, the normal negotiating date should apply.

iv. All other improvements including non-wage benefits should be kept within the overall pay figure except as provided for in the current policy; improvements in (or the introduction of) occupational pensions schemes up to the contracting-out level provided for in the Social Security Pensions Act can also be implemented outside the pay figure.

v. Negotiators will be responsible for ensuring that earnings do not increase beyond these levels. Where unions experience difficulty in interpreting the guidelines in relation to their own negotiating situation, they should approach the TUC for guidance.